

# CHINA UPDATE



China Strengthens Protection on Female Employees .....	1
Validity of Valuation Adjustment Mechanism in China.....	2
Supreme Court of China Issues Judicial Interpretation Governing Private Antimonopoly Litigations .....	3

## China Strengthens Protection on Female Employees

### Key Points

- New regulations extend maternity leave for birth-giving and explicitly specify maternity leave for miscarriage.
- New regulations encourage employers to participate in maternity insurance programs.
- New regulations classify protection on female employees into four categories.
- Employers may face administrative sanction for violation of the new Regulations.

### Background

On April 28 2012, the Special Labor Protection Regulations for Female Employees (the “Regulations”) entered into force, replacing the old Regulations on Labor Protection of Female Employees.

### Highlights of the Regulations

- Maternity leave may be 15 days, 42 days or 98 days, as the case may be.
- Maternity insurance may be more attractive to employer.
- Employer has to assume obligations and liabilities.
- Maternity leave for birth-giving is extended from 90 days to 98 days.
- Female employees that miscarry within 4 months of getting pregnant are entitled to 15 days maternity leave.
- Female employees that miscarry after 4 months of pregnancy have 42 days maternity leave.

### Employers' Obligation – Summary

#### All Female Employees

- Employers must prevent and put a stop to sexual harassment of female employees in the workplace.
- Employers shall organize training to female employees on labor safety.
- Employers must notify the female employees in writing if there is any of their work falls into the prohibited scope of work under the Regulations.

- The employer must not request female employees to engage in any work as listed Article 1 and Article 2 of the Addendum.

#### Pregnant Female Employees

- Employers shall pay pregnant employees normally when they go for pre-natal medical checks during working days.
- Employers shall reduce work load or arrange other suitable work if pregnant employees could not adapt to their original work and there is a written advice from a doctor.
- The employer must give 7-month pregnant employees (and those later in the pregnancy) a break during the working hours every day.
- Female employees pregnant for 7 months or more must not be asked work overtime or at night or engage in any work listed in Article 3 of the Addendum.

#### Nursing Female Employees

- Employers must give one-hour break for breast-feeding during the working hours every day.
- Nursing female employees must not be asked work overtime or at night or engage in any work listed in Article 4 of the Addendum.

### Conclusion

These regulations seek to strengthen the protection of female employees and provide numerous regulations that employers must strictly adhere to.

Employers are subject to administrative sanctions for violating any of the above obligations. Where violations occur, employers may be fined between RMB 1,000 and RMB 5,000 for each female employee it concerns. Employers requesting a pregnant or nursing employee to perform any prohibited work may be subject to a fine ranging from RMB 50,000 to RMB 300,000. In serious cases, the government authorities may order the employer to cease or close its business.

It is essential that companies understand these regulations to ensure they avoid potentially substantial financial sanctions.



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# Validity of Valuation Adjustment Mechanism in China

## Key Points

This summary discusses the following points:

- Are valuation adjustment mechanism (VAM) provisions commonly used by PE/VC in investment agreements in the People's Republic of China (PRC) still valid after the recent Gan Su High Court judgment?
- How can investors protect their interests if the VAM provision is not valid?
- Can investors adopt a different type of structure in PE/VC investments in PRC to avoid this risk?

## Background

Gan Su Shi Heng Nonferrous Metals Recycle Co., Ltd. (Shi Heng) was a wholly owned subsidiary of Wisdom Asia Limited (Wisdom), a Hong Kong company. In November 2007, Hai Fu Investment Co. Ltd (Hai Fu) entered into a Subscription Agreement with Shi Heng, Wisdom and Lu Bo (Wisdom's legal representative) to subscribe for 3.85 percent equity interest in Shi Heng by investing RMB20 million in Shi Heng. After the completion of the investment, Hai Fu held 3.85 percent of Shi Heng's equity interest and the remaining equity interest is held by Wisdom.

The Subscription Agreement contains a standard VAM and share repurchases provisions as follows:

1. If Shi Heng's 2008 net profit was lower than RMB30 million Hai Fu may claim compensation from Shi Heng and Wisdom through a formula stipulated in the Subscription Agreement (VAM Compensation).
2. If Shi Heng was not listed on a stock exchange before October 2010, Hai Fu may request Wisdom to repurchase all its shares in Shi Heng.

Hai Fu and Wisdom also entered into an Equity Joint Venture Contract (EJV Contract) specifying their rights and obligations in Shi Heng. Both the Subscription Agreement and the EJV Contract are approved by the Gan Su government authorities.

After the investment, Shi Heng continued to lose money and refused to provide VAM Compensation to Hai Fu. Hai Fu sued all three parties (Shi Heng, Wisdom and Lu Bo) for VAM Compensation due to their breach of the Subscription Agreement in December 2009.

## Summary of Court Decisions

### Gan Su High Court

Gan Su High Court held that the VAM provision was invalid for the reason that VAM provision leads to a consequence where Hai Fu needs not bear any investment risk in Shi Heng as a shareholder. Based on a Supreme Court guidance note, the High Court found that such an investment by Hai Fu is a de facto loan if the investor neither participates in the operation of the joint venture nor bears any responsibility or risk, and receives principal and interests after a fixed term or fixed profit at regular intervals regardless whether the joint venture is making profit or not. The Subscription Agreement for such

investment shall be deemed to be invalid for the violation of relevant financial regulations. The Gan Su High Court therefore rejected Hai Fu's claims and ordered Shi Heng and Wisdom to return the investment amount with interest to Hai Fu.

According to information from local press, this case is currently under the review by the Supreme Court in Beijing. The final result is yet to be announced.

## What Does the Courts' Decisions Tell Us?

Subject to the review decision by the Supreme Court in Beijing, the Gan Su High Court judgment does post challenge and risk on the enforcement of VAM provision/arrangement of the PE/VC investment cases in PRC. According to the Gan Su High Court judgment, such PE/VC investment with VAM provision may be considered as a loan and is invalid.

### How to Protect Investor's Interests if the VAM Provision is Not Valid

There may be two situations where the court may have different view on this type of VAM provision:

1. The original shareholder provides for personal/corporate guarantee to the investor for the enforcement of such VAM provision; or
2. The Subscription Agreement is a framework agreement that is governed by law in other jurisdiction, e.g., Hong Kong law.

Further, as Wisdom is a Hong Kong company and Shi Heng is a wholly owned foreign investment company in PRC, so it is possible that Hai Fu can use a special investment vehicle in Hong Kong or other offshore jurisdictions to form a joint venture with Hai Fu in overseas. Such offshore investment or cooperation will not be governed by PRC law, provided it complies with certain PRC regulations, e.g., tax regulation.

## Conclusion – Avoiding the Risk Altogether

The Gan Su High Court judgment reminds the PE/VC investors that may be time to reconsider the validity of the VAM provision in their investment agreements or even restructure its investment in PRC in order to reduce the potential risk that their PE/VC investments with VAM provision may be considered as a loan and is invalid in PRC. Proper legal advice in this type of PE/VC investment is therefore recommended.



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# Supreme Court of China Issues Judicial Interpretation Governing Private Antimonopoly Litigations

## Key Points

This summary discusses the following points:

- Civil cases are not conditioned upon administration investigations.
- Jurisdictions on Anti-monopoly cases are clarified.
- Burden of proof is re-allocated.
- More private actions are expected to be seen.

## Background

On 1 June 2012, the Rules of the Supreme People's Court on Several Issues Concerning the Application of Law in Hearing Civil Cases Caused by Monopolistic Conduct ("the Rules") became effective. The Rules contain 16 articles intended to correct the ineffectiveness of the Anti-Monopoly Law of the PRC (AML).

## Highlights of the Regulations

### Relationship of Antitrust Administrative Investigations and the Judicial Process

The Rules have clarified the AML's vague guidance of whether an administrative investigation and decision must be conducted before a civil case can be brought. They now clearly state that a plaintiff can either:

- Directly bring a civil action.
- Bring a civil action after the decision of the AML enforcement agencies is confirmed effective.

### Clarification of Jurisdiction

Intermediate courts with more experienced judges now have jurisdiction for anti-monopoly cases. The Rules explicitly provide that civil monopoly cases of the first instance shall be heard by any of the following:

- Certain intermediate courts – e.g., as those in capital cities of the provinces.
- Cities separately listed on the State plan.
- Cities directly under the State Council.
- Cities designated by the Supreme Court .

## Allocation of Burden of Proof

Previously, it was extremely difficult for a plaintiff to win an anti-monopoly lawsuit because of the difficulty in proof. The Rules have adjusted some burdens of proof for the three kinds of monopoly under the AML:

- Monopoly agreements.
- Abuse of dominant market position.
- Administrative monopoly.

The Rules, however, have only adjusted the first two kinds of monopoly activities.

For "horizontal agreements" it is the defendant's responsibility to prove the agreement does not have anticompetitive effects. Otherwise, the defendant shall bear the adverse result against itself.

For "abuse of dominant market position", the plaintiff must bear the burden of proof regarding the dominant position of the defendant in the relevant market and the abusive conduct. Defendants bear the burden of proving the justifications of its conduct if it asserts such a defense. In addition, the plaintiff can use information publicly released by the defendant as evidence of its dominance.

### Limited Public Interest Lawsuit

Even the plaintiff has not been damaged and assumed the loss by the monopolistic conduct they can still claim a contract or an articles of associations of industry associations has violated the AML. However, in these instances the plaintiff cannot claim the damages and compensation if they didn't incur any losses but the plaintiff could request the related parties to stop the activities. This is because in the past many courts refuse to accept cases due to lack of actual losses. These articles now pave the way for the public-interest law suit.

### Expert Witness and Independent Professional Institutions

The Rules specifically stipulate that parties to litigations can apply to the court and entrust one or two specialists to testify at court hearings. They can also apply to the court to entrust an independent institution to conduct market survey or economic analysis.

## Conclusion

The Rules have helped fill in the gap between the AML and its implementation in civil litigations, although a lot still remains uncertain. It is expected that, because of the Rules, AML private actions will play an increasingly important role in the AML enforcement regime of China.



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